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Supreme Court of the United States

OCTOBER TERM, 1931

No 582

WOOLFORD REALTY COMPANY, INC.,

PETITIONER,

v.

J. T. ROSE, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA

On Writ of Certiorari to the Circuit Court of Appeals for the Fifth Circuit

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BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

Opinions Below

The opinion of the Circuit Court of Appeals for the Fifth Circuit is reported at 53 F. (2d) 821. The opinion of the District Court for the Northern District of Georgia is reported at 44 F. (2d) 856.

Jurisdiction

The judgment of the Circuit Court of Appeals for the Fifth Circuit was entered November 13, 1931 (R. 24). Petition for writ of certiorari was filed

December 21, 1931, and the writ was granted January 25, 1932 (R. 26). The jurisdiction of this Court rests on Section 240 of the Judicial Code as amended, 28 U. S. C. Sec. 347.

Question Presented

This case presents the question whether, under the Revenue Act of 1926, "net losses" sustained by a corporation in two years when it was not affiliated with any other corporation may be used as deductions in computing the consolidated net income of that corporation and another corporation in the succeeding year during which the two corporations were affiliated and for which a consolidated return was filed, when the corporation which had sustained the "net losses" has, without consideration of such "net losses," no separate net income of a plus quantity in such succeeding year.

Statutes and Regulations Involved

The statutes and regulations involved are rather lengthy and are all quoted in the Appendix, and extracts from same are quoted in the text where it is thought to be more convenient to give quotations than to refer to the Appendix.

Statement of the Case

Petitioner sued the Respondent to recover certain income taxes alleged to have been erroneously and illegally collected. Petitioner's declaration showed the following facts (R. 2-6):

Petitioner and Piedmont Savings Company are separate corporations. They were not affiliated in 1925 and 1926, but were affiliated throughout 1927

through the ownership by Petitioner of 96% of the stock of Piedmont Savings Company. The corporations filed separate returns for 1925 and 1926, but filed a consolidated return for 1927 under Section 240 of the Revenue Act of 1926.[1]

In computing the consolidated net income of the group for 1927 for income tax purposes, the Commissioner of Internal Revenue has taken into consideration and allowed all the deductions allowable to each of the members of the group under Section 234 of the Revenue Act of 1926, but the Commissioner has refused to allow as deductions claimed under Section 206 of that Act, the amount of certain statutory "net losses" (as defined in Section 206) sustained by Piedmont Savings Company in the years 1925 and 1926, in the respective amounts of $37,582.63 and $453.80. If such deductions were allowed, or if the amount of the "net loss" for 1925 alone were allowed, the allowable deductions would have exceeded the aggregate gross income, and no income tax would be payable under the consolidated return. A claim for refund was filed and this suit was brought upon its rejection. A demurrer to the petition was sustained by the District Court. (R. 8-10.) Judgment was entered dismissing the petition (R. 10), which was affirmed by the Circuit Court of Appeals for the Fifth Circuit (R. 17-25).

Although recognizing the propriety of allowing full use of all deductions available to Piedmont Sav-

[1]Pertinent statutory provisions and Treasury Regulations are quoted in full in an Appendix to this brief. Throughout this brief references to Section and Article numbers relate to Sections of the Revenue Act of 1926 and Articles of Regulations 69, unless otherwise indicated.

ings Company under Section 234 in consolidated returns, even where such deductions exceeded the income of that Company, the Circuit Court of Appeals took the position "that the statutory net loss deduction was personal to the taxpayer sustaining it, could be availed of in the following year by that taxpayer alone, and by him only to the extent that he had net income in that year."[2] The learned Judge apparently means by "net income" the amount by which gross income exceeds the deductions allowable under Section 234(a) and is of the opinion that where these deductions exceed gross income there is no "net income." Since in 1927 the gross income of Piedmont Savings Company was exceeded by the deductions allowable to Piedmont Savings Company under Section 234 of the Revenue Act of 1926, the Court held that Piedmont Savings Company had no "net income" and that therefore its "net losses" for the two preceding years were not deductible and should be disregarded in the computation of consolidated net income.

Specification of Errors

1. The Circuit Court of Appeals erred in finding and holding that a statutory "net loss" (within the meaning of Section 206 of the Revenue Act of 1926) incurred by a corporation in one year (1925 and 1926), when not affiliated, may not be used to reduce consolidated net income (within the meaning of Section 240 of the Revenue Act of 1926) of an affiliated group, of which such corporation is a member, in a

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[2]The quotation is from the opinion of the Circuit Court of Appeals for the Fifth Circuit in the case of Planters' Cotton Oil Co., Inc. v. Hopkins, 53 F. (2d) 825, 826, where the Court describes its holding in the case at bar.

subsequent year (1927) in which the corporation which has sustained the "net loss" does not have gross income in excess of the deductions allowed by Section 234 (a) of the Revenue Act of 1926.

2. The Circuit Court of Appeals erred in affirming the judgment of the District Court sustaining the general demurrer to the petition.

Summary of Argument

All deductions allowable to each of the individual affiliated corporations filing a consolidated return, are allowable in computing the consolidated net income of the group, regardless of whether the deductions of an individual corporation are in excess of the gross income of that particular corporation. The Act and Regulations require the deduction of statutory "net losses" without limitation in a consolidated return just as they require the allowance of any other deduction granted to a particular corporation.

While this result seems so clearly to be required by the Statute and Regulations as not to call for any extended discussion, we have gone into an analysis of the statutory provisions at considerable length in the belief that a full discussion of the "consolidated returns" provisions and the "net loss" provisions will enable the court the more clearly to dispose of the fallacious arguments which the Government bases upon the *language* of the Statute.

After showing under Headings 1 and 2 that the result contended for by Petitioner *is required by the language* of the Statute and Regulations, we proceed to discuss under the succeeding Headings arguments of the Government and reasons advanced by the

Courts below which have no reference whatever to the *language of* the statute but are based upon supposedly "*equitable*" *considerations*. Petitioner rests its case squarely on the statute and discusses these so-called equitable considerations solely for the purpose of meeting arguments upon that basis advanced by the Government.

The argument is developed under the following Headings:

1. *General Nature and Purpose of Consolidated Returns Provisions, and the Method Provided for the Computation of Consolidated Net Income.*

2. *The Deduction Allowable under Section 206 is Allowable in Computing Consolidated Net Income upon Exactly the same Terms and to the same Extent as the Deductions under Section 234 and is not Limited by the Amount of the Income of the Corporation Previously Sustaining the "Net Loss."*

3. *That the Deduction Here Claimed is not Inappropriate to the General Scheme of the Income Tax Act is Conclusively Shown by Regulations Under the Revenue Act of* 1928.

4. *Equitable Considerations Impose no Greater Restriction upon the Deduction of "Net Losses" in Consolidated Returns than in the Return of a Single Corporation into which Another Corporation Has Been Merged.*

5. *Losses Currently Realized are Not Limited by the Commissioner in Consolidated Returns Because in Substance Suffered in Other Years or Prior to Affiliation.*

6. *Affiliation or Non-affiliation at Time Net Loss was incurred Is Immaterial.*

7. *Petitioner Does not Contend that a "Net Loss" can be Deducted in Computing a "Net Loss."*

8. *Discussion of authorities.*

Argument

1. General Nature and Purpose of Consolidated Returns Provisions, and the Method Provided for the Computation of Consolidated Net Income.

Under the Revenue Acts each corporation is a separate taxpayer and most of the provisions of the Revenue Acts relating to corporations provide for the computation of the net income of a single corporation. The provisions of the Revenue Act of 1926, so far as now material, for the computation of the net income of a single corporation, are given immediately below.

Section 232 provides what constitutes "*net income*":

> "Sec. 232. In the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206 . . ."

Section 234 (a) provides:

> "Sec. 234 (a). In computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:"
>
> (There are then listed in subparagraphs 1 to 11 all deductions permitted in determining net

income except net losses brought forward from preceding years, which are covered by Section 206.)

Section 206 (a) fully defines what it designates a "*net loss*," a loss which may be carried forward from one year to another, and Section 206 (b) provides:

> "Sec. 206 (b) . . . the amount [of such "net loss"] shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year . . . and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year . . ."

The foregoing sections give the formula by which "net income" of an individual corporation, unaffiliated with other corporations, is to be computed.

It was found, however, that where the ownership of separate corporations is substantially identical it might result in great unfairness for the corporations to file separate returns and make separate tax computations as to each corporation. Since the 1918 Act, therefore, the Revenue Acts have contained provisions permitting the filing of consolidated returns by such corporations, and under the 1918 Act the Commissioner might require such corporations to file consolidated returns. Under the provisions of these returns each separate corporation remains the "taxpayer." There is no dispute between Petitioner and the Government on this point. But the income of the affiliated corporations is consolidated and *the tax is computed on this consolidated net income* as though it were the income of a single corporation.

The provisions of the 1926 Act with reference to "consolidated net income" are as follows:

> "Sec. 240 (a). Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return . . ."
>
> "(b). In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations . . ."

Article 635 of Regulations 69 provides:

> "Art. 635. *Consolidated net income of affiliated corporations.*—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, . . . *the consolidated taxable net income shall be the combined net income of the several corporations consolidated* . . . In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited." (Italics supplied.)

The undisputed purpose of consolidated returns is among other things: (1) the elimination of intercompany transactions, and (2) the offsetting of

losses of one corporation against the gains of another. With the exception of the "net loss" deduction it has been the universal practice of the Bureau of Internal Revenue to permit the full amount of the deductions of each corporation to be taken into consideration in computing the consolidated net income. This practice has been universal for thirteen years and is one of the advantages which has principally influenced corporations to file consolidated returns.

The practice is illustrated in the present case where the Commissioner has combined with the net income of the Petitioner amounting to $37,582.63 a minus figure of $453.80, which is the excess of Piedmont Savings Company's deductions under Section 234 (a) over its gross income.

There are two views as to the method which Article 635 of Regulations 69 prescribes for the computation of consolidated net income of affiliated corporations. We state these two methods without any effort to establish the correctness of the one rather than the other. One of the two must be correct. No other method has ever been suggested. Both reach the same result.

The more prevalent view as to the method prescribed for determination of consolidated net income is that so adequately set forth in the amici curiae brief of Mr. Robert N. Miller and Mr. John G. Buchanan and the longer amici curiae brief of Messrs. Weill, Satterlee and Lisenby. These gentlemen take the view, and very ably support it, that the net income of a consolidated group is arrived at by taking the aggregate of the gross incomes of all of the corporations affiliated, after eliminating intercompany

transactions, and then subtracting the aggregate of all of the deductions provided for the individual corporations. In this way there is no comparison between the gross income of a particular corporation and the deductions attributable to that particular corporation. We simply take the gross income of the group and subtract the aggregate of the deductions.

This is the method provided by the Regulations under the 1928 Act (which Act for present purposes is substantially identical with the 1926 Act) for the computation of consolidated net income.

Article 31 (a) of Regulations 75 under the 1928 Act provides:

> "Art. 31.—*Consolidated Net Income.* (a) *Definition.* Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as 'intercompany transactions')."

The other view is that the income of each of the affiliated corporations is determined separately after the elimination of intercompany transactions. Then when the separate income of each corporation is determined, the plus and minus figures are added together to get the net income of the consolidated group. Under this view the last clause of the first sentence of Article 635, quoted above, is taken to

mean, as it well may, that "the consolidated net income shall be the combined net *incomes* of the several corporations consolidated."

Whichever of the two views is adopted, the results are identical. It is immaterial, so far as the practical result is concerned, whether the gross incomes are added together and all the deductions then added together and subtracted, or whether the net income of each separate corporation is computed by taking the gross income of each corporation and subtracting from it the deductions of that particular corporation and then combining the plus and minus figures thus obtained.

The only difficulty with the second view is that it requires the concept of "*net income*" as a minus quantity, but that difficulty is apparent only and not real. Net income in the commercial sense may not ever be a minus quantity, but "*net income*" as used in the Revenue Acts is not commercial net income. "*Net income*" under the Act has a meaning definitely defined by the Act. Whatever it might mean generally Congress can define it as it wishes for the purpose of the Statute. It has clearly and definitely defined it in Section 232, above quoted (p. 7, *supra*). It did not see fit to define it as "commercial net income."

"*Net income*" under the Act may be, and in many instances is, altogether different from commercial net income, and may be a minus quantity when commercial net income would be a plus quantity. For example, the "*net income*" of a corporation under the Statute is computed by including in the deductions from gross income dividends received from domestic corporations [Section 234 (a) (6)], which of course

would not be deducted in computing commercial net income. A corporation might have gross income of $50,000.00, of which $45,000.00 consists of dividends from domestic corporations. It might have deductions under the other sub-paragraphs of Section 234 (a) amounting to $40,000.00. The result under the Act would be "net income" of minus $35,000.00, whereas the *commercial net income* of the corporation would be *plus* $10,000.00.

The former Secretary of the Treasury himself has recognized this obvious point that net income may be either a positive or a negative quantity. In a statement published in the Internal Revenue News (Volume 2, No. 8, page 17, February 1929), in explaining the new Regulations under the Revenue Act of 1928, Mr. Mellon stated that

> "The net income of the affiliated group is, in effect, the *algebraic* sum of the net incomes of the separate corporations in the group . . ." (Italics supplied.)

Mr. Mellon must have used the word "*algebraic*" intentionally. Its well defined meaning shows that he considered "*net income*" might be either a positive or a negative figure. (Webster's International Dictionary, "algebraical.")[3]

Yet this concept of even statutory "*net income*" as a minus quantity was one which the learned Circuit Judge would not accept for a moment. He said of it:

> "Were it not for the fact urged upon us by appellant with such earnestness that the Board of

[3]The foregoing paragraph is taken from the very excellent brief which Mr. Rollin Browne as amicus curiae has filed herein (page 7).

> Tax Appeals and the Circuit Court of Appeals for the Third Circuit have by construction found that the words in question do have the meaning which appellant contends for, we should take the simple view which Alice took before her encounter with the master logomachist, that words mean what they say, and not the opposite, and simply say, without more ado, that the words 'net income' mean net income; they do not, they cannot mean minus net income or loss." (R. 20.) 53 F. (2d) at 823.

The writer is not sufficiently versed in the political constitution of Wonderland to know just where the sovereignty there resided nor what portion of it was delegated to the master logomachist; but if the master logomachist was vested with such authority in defining the meaning of words in Wonderland as here resides in Congress in defining, for the purpose of its own enactments, terms used therein, words in Wonderland no doubt meant what the master logomachist said they should mean and not what Alice might otherwise have thought they meant.

The whole difficulty with the approach of the Circuit Court of Appeals to the question involved in this case is that it entirely ignored the fact that "*net income*" as used in the Act is precisely defined by the Act. "*Net income*" when it is defined by Congress in a Revenue Act need not mean commercial net income, or accounting net income; but it means just exactly what Congress says "*net income*" shall mean. And if within this definition it may be a minus quantity, it may be such, notwithstanding any other authority to the contrary.

Again the Circuit Court of Appeals says that the

words "net income," as used in the Revenue Act of 1926, "were used with the practical end of taxation in view, determining the amount which the taxpayer will contribute to the support of the Government in the taxable year." (R. 20.) The learned Judge indicates that the term "*net income*" as used in the Act cannot represent a minus quantity for the reason that such a minus quantity would have no practical effect in the computation of taxes. This view of the matter overlooks the fact that Section 240, relating to consolidated returns, is also an integral part of the same Revenue Act, and that a minus quantity representing the "*net income*" of an affiliate may have a most important *practical* effect upon the computation of consolidated net income and the determination of the amount of taxes to be assessed thereon. The usual provision for basing an income tax upon the "*net income*" of the single taxpayer has been superseded in the present case by the consolidated returns provision which provides for the assessment against each affiliate of its proportionate part of the total tax based upon the "consolidated net income." The practical effect of the concept of minus net income is illustrated in the case at bar where the net income of Petitioner has been reduced by the Commissioner by the sum of $453.80 from Piedmont Savings Company.

We call attention again to the fact that the concept of "*net income*" as a minus quantity is not necessary if Article 635 of Regulations 69 is construed to be equivalent to Article 31 (a) of Regulations 75 and as providing for the addition of gross incomes and the subtraction therefrom of an aggregate of the deductions. The concept of "net income" as a minus

quantity is necessary in consolidated returns only if we interpret Article 635 as requiring that the net income of each corporation is computed separately and the results combined.

But whichever of the two methods above suggested for the computation of consolidated net income is considered as required by Article 635 of Regulations 69, the Treasury Department admits that none of the deductions under Section 234 (a) is limited to the gross income of the particular corporation on whose account the deduction arose, but that each of them is deductible in full in computing the statutory "*net income*" of the consolidated group, regardless of whether they would be deductible in computing commercial income or not. In other words, the Treasury Department concedes that consolidated net income is made up in effect of the algebraic addition of the positive and negative "*net incomes*" of the members of the group where any such negative "*net income*" results from an excess of the deductions allowed in Section 234 over the gross income. In the present case the deductions allowable by Section 234 to Piedmont Savings Company in excess of the gross income of that Company amounted to $453.80 and that figure has been combined with the plus "net income" of Petitioner, whatever were the mechanics of the combination.

The only point which the Government makes is that the deduction allowable under Section 206 (b) is different in this respect from the deductions under Section 234 (a) and is limited in amount to the sum by which the gross income of the particular corporation in the taxable year in question exceeds the de-

ductions allowable to that individual corporation under Section 234 (a).

2. The Deduction Allowable under Section 206 is Allowable in Computing Consolidated Net Income upon Exactly the same Terms and to the same Extent as the Deductions under Section 234 and is not Limited by the Amount of the Income of the Corporation Previously Sustaining the "Net Loss."

Section 206 (a) provides for the determination according to clear statutory provisions of what that section designates as a "*net loss.*" That the "net loss" defined in Section 206 (a) is a statutory concept and is not to be confused with loss in general or with minus "net income" is made clear by Article 1621 of Regulations 69, which provides:

> "Art. 1621. The amount properly allowed [as a 'net loss'] may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute."

Section 206 (b) with reference to the deduction of the statutory "net losses" from gross income in succeeding years provides:

> "Sec. 206 (b). If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year'), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net in-

come for the next succeeding taxable year (hereinafter in this section called 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

Section 232 provides in the same identical language for this deduction and the deductions provided by Section 234 (a) in the computation of net income. Section 232 makes no distinction whatever between the deductions under the two sections.

Then turning to the language of Sections 206 (b) and 234 (a) we find that they provide in substantially identical language for the deduction defined by the respective sections.

Section 234 (a) provides:

"*In computing the net income* of a corporation subject to the tax imposed by section 230 *there shall be allowed as deductions*:" [And the deductions are then listed.] (Italics ours.)

And Section 206 (b) provides that

"the amount thereof [of the 'net loss'] *shall be allowed as a deduction in computing the net income* of the taxpayer." (Italics ours.)

The Petitioner contends that without doing gross violence to the clear language of these provisions, the deductions cannot be treated differently. Both are made deductible in computing net income and one is not more or differently deductible than is the other. If one can be carried into consolidated returns to the full extent thereof, then the deductions under the other are fully deductible in a consolidated return. We have shown under Heading 1 that the deductions under Section 234 (a) are taken to the full extent thereof in consolidated returns. Consequently it is

clear that deductions under Section 206 (b) are deductible in full in a consolidated return.

The Circuit Court of Appeals (R. 22) has treated the deduction under Section 206 (b) as a *special deduction* and has stated that it is available only in strict accordance with the terms of the statute which gives it. So far as we are aware, all deductions are dependent upon the terms of the statutes which give them. We do not know how the Court can consider one deduction *special* and another *ordinary*. There is no measuring stick except the statute and that places all of the deductions upon the same basis. Under Section 234 (a) (6) dividends from domestic corporations are deductible from income. That is absolutely contrary to commercial and accounting practice. Upon what possible theory can the Court consider this as an *ordinary deduction* and consider a "net loss," brought forward from a preceding year and made deductible by the specific terms of the statute, a *special deduction?* It is true that the "net loss" arises out of transactions in a preceding year, and in this case prior to affiliation, but by the express terms of the statute it is made deductible in 1927 equally with any other deductions given by the statute.

The only argument urged with any seriousness by the Government against this view in the Circuit Court of Appeals was the following:

Section 206 (b), after providing for the deduction of a "net loss" in the second year, the year following the accruing of the "net loss," then provides:

> "and if such net loss is in excess of such net income (computed without such deduction), *the*

amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year." (Italics ours.)

The deduction—so the Government's argument runs—therefore cannot be taken in the second year in excess of the net income computed without such deduction, because the statute expressly limits the deduction of "net loss" in the second year to an amount sufficient to eliminate any plus figure resulting from subtracting from gross income the deductions provided by Section 234 (a). The Government contends that if deduction of the excess is permitted in consolidated net income in the second year, the corporation which sustained the net loss will still be entitled to the deduction from its net income in the third year, and there will result therefore a double deduction, which, it is argued, is clearly contrary to the intent of the statute.

There are at least two answers to this argument:

First. The simplest answer is that we are here concerned with the "*third year*" and not with the "*second year,*" and there is no provision in Section 206 (b) which can possibly be held to limit the deduction in the "*third year*"; and there is no provision for carrying the "net loss" forward further against the net income of the particular corporation sustaining the "net loss" and there is no possibility of any double deduction.[4] It will be recalled that the big

[4]The argument which might be advanced to the effect that it is unreasonable to assume that Congress intended such a "net loss" to be deductible in the "third year" on a different basis than in the "second year" is sufficiently disposed of by the reasoning of the Court in Burnet v. Moore Cotton Mills, 49 F. (2d) 59 (C. C. A. 4th, 1931).

"net loss" sustained by the Piedmont Savings Company in this case was sustained in 1925 in the sum of $43,478.25 and the total consolidated taxable net income of the group in 1927, which is the year in question, computed without the benefit of this deduction, amounts to only $36,133.82, so that it is immaterial for the purposes of this case whether the "net loss" of $410.82 sustained by the Piedmont Savings Company in 1926 is held to be deductible or not.

Second. The Government's argument is unsound because it fails to take into consideration the limitations placed upon the carrying forward of net losses of an individual corporation by its consolidation with other corporations who in effect are given the benefit of a loss in a consolidated return. Section 206 (b) does not as a matter of fact provide that only such portion of the "net loss" as shall be necessary to eliminate the net income computed without the benefit of the "net loss" shall be deducted in the second year. It provides that the "net loss" shall be deducted in computing net income for the second year, but it goes ahead and provides that where a full benefit is not received from this loss because of the smallness of the taxpayer's income in the second year it may be carried forward to the third year. But naturally where the full benefit of the loss has been received in a consolidated return it may not be carried forward and taken again. The Government's argument, if carried to its logical conclusion, would lead to an absurd result for which the Bureau of Internal Revenue has never contended. Consider the following situation:

Corporations A and B are consolidated for 1926.

Corporation A has gross income in excess of all deductions amounting to $50,000.00. Corporation B sustains in its 1926 operations a loss of $50,000.00, arising in such manner as to make it a "net loss" within the provisions of Section 206. Naturally, however, the $50,000.00 loss of B is offset against the $50,000.00 gain of A resulting in consolidated net income of zero. Now under the literal language of Section 206 (b) this "net loss" of B is deductible in computing the net income of B in 1927. We do not believe this Court would sustain the allowance of this deduction in 1927. If we should be wrong, and if the Court should sustain such a deduction, it would simply result in a double deduction. Certainly no one would contend that the losses of B currently happening in 1926 when the corporations were consolidated could not be offset against the gains of A in that year. The Bureau of Internal Revenue has always permitted the deduction of these items in consolidated returns, regardless of whether the deductions would constitute a "net loss" if the corporation sustaining the deductions were standing alone. To hold the contrary would be to subordinate the very important consolidated returns provisions of the statute to an entirely strained construction of the net loss provisions of the statute. And yet such a construction of the statute which would prevent the deduction of current losses in a consolidated return—because they are of the sort which Section 206 (b) provides that an unaffiliated corporation carry forward as a "net loss" to the "*second year*"—would be no less unreasonable than is the Government's argument in this case to the effect that the "net loss" of Piedmont Savings Company cannot be taken in a consolidated return in

the "*second year*" because Section 206 (b) provides that it shall be carried forward to the "*third year.*"[6]

While the argument above referred to was the argument most strenuously urged, and in fact the only argument seriously urged, by the Government in presenting this case before the Circuit Court of Appeals, it was in no way relied upon by the Circuit Court of Appeals and that Court did not even see fit to mention it in its opinion.

The only other argument on the language of the statute which even superficially has the slightest shadow of plausibility in it is the argument that, since Section 206 (b) provides for the deduction of a "net loss" in the second and third year in computing the net income of the "*taxpayer,*" it is therefore *personal* to the particular corporation which sustained it. A comparison of Section 234 (a) with Section 206 (b) will show conclusively that such a contention is absolutely without merit.

Section 234 (a) states that the deductions therein provided shall be used "in computing the net income of a *corporation subject to the tax imposed by Section 230.*" Section 206 (b) permits the deduction "in

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[6]See the discussion of this matter on pages 8 and 9 of the amicus curiae brief of Mr. Rollin Browne. Cf. Kaiwiki Sugar Co., 21 B. T. A. 997. In this case part of a corporation's net loss went to wipe out the income of an affiliate in a consolidated return. In the succeeding year the corporation suffering the net loss was no longer affiliated and sought to apply the full amount of the net loss against its income for that year. The Commissioner urged and the Board properly held that the part of the net loss which was used to reduce consolidated net income to zero in the prior year could not be again taken as a net loss by the corporation sustaining it.

computing net income of the *taxpayer*." But Section 206 (b) is dealing with both individual and corporate taxpayers. Section 234 (a) on the other hand is dealing only with the corporations subject to the tax imposed by Section 230. "Taxpayer" is not a more limited term, as this argument suggests, but is a more general term than, and includes, "corporations subject to the tax imposed by Section 230." But the important point is that in each case the section permitting the deductions is referring to a single legal entity, and this is just as much true of the one as of the other.

It would be very fanciful to say that the deduction allowed by Section 206 (b) to a "*taxpayer*" is personal to a particular corporation, but that the deductions allowed by Section 234 (a) to a "*corporation subject to the tax imposed by Section 230*" are not personal to the particular corporation, so that the latter may be taken into a consolidated return and be taken advantage of by the group to a greater extent than the former. One is no more personal than the other. Each is personal if the particular section granting it is read alone, but neither is purely personal when read in the light of the consolidated returns provisions, as they must be.

It is submitted that under the clear general terms of Sections 232, 234, 206 and 240 and Article 635 of Regulations 69, there is absolutely no basis for treating the deduction allowed by Section 206 (b) differently from the deductions allowed by Section 234 (a) in computing consolidated net income. If there were any extrinsic reason to suppose that Congress intended to exclude one kind of deduction in

consolidated returns, an answer would be found in a fundamental principle of statutory construction. For, in Section 240, relating to consolidated returns, Congress has *expressly* limited the use of the *specific credit* authorized by Section 236 (a) in the case of a domestic corporation. In view of the express limitation on the use of the *specific credit* of individual corporations in consolidated returns, and in view of the failure of the Act to limit in any way the use of any *deductions* of individual corporations in consolidated returns, it must be concluded that no limitation was intended on the use of such deductions in consolidated returns. *Expressio unius est exclusio alterius.*

The Circuit Court of Appeals, however, apparently realizing that it could not rest its decision on the language of the Act, seeks to support its decision by relying upon principles not expressed in the statute but derived by the Court from sources unknown to us. We believe the error into which the Court has fallen shows as clearly as anything could how very dangerous it is for a Court in construing a legislative enactment, and especially a taxing statute—instead of relying upon the language of the Act before it—to rely upon its own concepts of the most appropriate result to be obtained.

3. That the Deduction Here Claimed is not Inappropriate to the General Scheme of the Income Tax Act is Conclusively Shown by Regulations Under the Revenue Act of 1928.

But the reason upon which the Circuit Court of Appeals seemed most strongly to rely in refusing to allow the deduction in this case is that it would be "generally inappropriate to the Federal scheme of

income taxation, designed as it is with the sole exception of the statutory net loss provision, to make each person subject to the tax, pay taxes on his income for the year in which it accrues." (R. 19.)

The District Court was of the opinion that it "would not be in line with, but antagonistic to, the intent of and the reasons for the law" permitting consolidated returns to hold that an affiliated group could take advantage of the net loss occurring prior to affiliation to an extent greater than the income of the corporation which sustained the net loss. (R. 9-10.)

That the Courts were entirely in error as to Petitioner's claim being inappropriate to the general scheme of taxation is clearly shown by the Regulations under the 1928 Act which cover by specific terms, and not merely by general language, the exact situation which here exists. Article 41 (c) of Regulations 75 provides:

> "Art. 41 (c). *Net Loss Sustained by Separate Corporation prior to Consolidated Return Period.* A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

Regulations 75 were promulgated under the Revenue Act of 1928. They are expressly made applicable only to 1929 and subsequent years. (Regulations 75, page 358.) These Regulations therefore do not in any way cover the present case and we are not even referring to them for the purpose of construing the language of earlier Acts and Regulations. *We refer to them here for one purpose alone, and that is for the purpose of showing that the result for which we here contend is not inappropriate to the general scheme of income taxation.* The first time the Commissioner of Internal Revenue and the Secretary of the Treasury ever adverted specifically to this situation in exercising their regulation making power, they permitted exactly what Petitioner now claims. This would seem to show, as clearly as anything could, that there is nothing unreasonable in the result.

It will certainly not be seriously contended that the general scheme of income taxation under the 1926 and 1928 Acts is so different as to make the result for which we here contend unreasonable under the former when it is expressly permitted under the latter. There is some difference in the requirements necessary to constitute affiliation, and the regulation making power of the Commissioner is somewhat broader under the later Act; *but the general character of consolidated returns and the principle of computing net income on a yearly basis* remains the same, and the material language of the "net loss" sections is identical.

It will be noted in Article 41 (c) of Regulations 75, quoted above, that there is a limitation placed on the deduction of a "net loss" happening prior to affiliation in the following language:

"but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group."

It is very significant that this limitation applies only in case the affiliation took place after January 1, 1929, and *it is the limitation, and not the general allowance of the deduction in a consolidated return, that is removed where the affiliation took place prior to January 1, 1929.*

It is interesting too to note what the Treasury Department did when it finally sought by regulations under the 1928 Act to limit net loss deductions occurring prior to affiliation in order to prevent unfair use being made of such deductions by the affiliated group. It did not adopt a limitation which in any way resembles the limitation which the Government now urges. The Government's contention here is that the net loss shall be used in the consolidated return only to the extent of what the plus "net income" of the particular corporation would be computed without the "net loss deduction."[6] Regulations 75, on the other hand, limit the *amount of the usable net loss* and provide *no restriction* as to the *income against which* the "net loss" may be used. The limitation is that the *usable amount* of the net loss shall not exceed the cost or other basis of the stock of the company suffering such loss. *The question whether the net loss*

[6]This limitation was adopted by the Circuit Court of Appeals for the Fifth Circuit. See the language of that Court in its opinion in Planters' Cotton Oil Company v. Hopkins, quoted supra, page 4, in which the Court described its holding in the case at bar.

company has income or loss is entirely immaterial. The allowable "net loss" is limited to the cost of the stock of the net loss company, *even though the separate income of that company is greater than such cost;* and such amount of net loss is deductible, *even though that company had no income.*

Although the Regulations under the 1928 Act were expressly called to the attention of the Circuit Court of Appeals in two briefs and in oral argument as showing clearly that the District Court was in error in assuming that the result for which the Petitioner contends is out of keeping with the general scheme of income taxation, the Circuit Court of Appeals in its opinion does not even refer to the 1928 Act or to Article 41 (c) of Regulations 75.

4. Equitable Considerations Impose no Greater Restriction upon the Deduction of "Net Losses" in Consolidated Returns than in the Return of a Single Corporation into which Another Corporation Has Been Merged.

It is believed that the Circuit Court of Appeals, in imposing a limitation on the use of a "net loss" deduction (which it does not impose on the use of any other deduction) in consolidated returns, has acted on the view that some such limitation is necessary to prevent an unjust use of the net loss deduction through affiliation. The real reason for the decision of the Circuit Court of Appeals is summarized in the following language from its opinion:

> "On the face of it, a ruling which permits a corporation with a consistent record of gains, to affiliate with one having a large accumulation of statutory net losses for the purpose and with the result of using these losses in the year of affiliation as deductions from its income in that

year, appears generally inappropriate to the Federal scheme of income taxation, designed as it is with the sole exception of the statutory net loss provision, to make each person subject to the tax, pay taxes on his income for the year in which it accrues." (R. 19) 53 F. (2d) at 823.

The District Court in the case at bar acted on the same considerations (R. 9-10) 44 F. (2d) at 857.

With this apparent evil before it, the Circuit Court of Appeals felt compelled to impose a restriction upon the use of "net loss" deductions in consolidated returns by prohibiting the use of such "net loss" deductions to reduce below zero the income of the corporation sustaining the "net loss." As we have previously attempted to show, the imposition of such a limitation is entirely beyond the province of the Court and the result obtained by following Petitioner's view certainly does not require the imposition of limitations not provided by the Statute.

Exactly the same results, to avoid which the Circuit Court of Appeals has written an exception into the Statute, may be accomplished without resort to consolidated returns, and by a method as to which there can be no legal dispute. Thus if we can imagine a designing corporation looking for "net losses" to buy up or deal in (if there be any such corporation) it need not *simply affiliate* with a corporation having a "large accumulation of net losses" with the view to getting the benefit of the net loss deductions in a consolidated return. All that is necessary is *to merge* the prosperous business with the net loss corporation under the charter of the latter.

Then there will be no question of a consolidated re-

turn, and the results which the Government seeks to avoid by construction of the consolidated return provisions are just as easily accomplished. The single corporation which sustained the "net loss" prior to merger continues as the same taxpayer and will simply carry its "net loss" of the preceding year into its return for the year following the merger. Since the results which the Circuit Court of Appeals sought to avoid can so easily be accomplished without resort to consolidated returns, will the Government contend that some further limitation is to be imposed on the "net loss" deductions in situations like the one suggested where consolidated returns are not involved?

5. Losses Currently Realized are Not Limited by the Commissioner in Consolidated Returns Because in Substance Suffered in Other Years or Prior to Affiliation.

The Government has urged that the "net loss" deductions authorized by Section 206 are to be distinguished from the other deductions authorized by Section 234 (a) under the circumstances of the present case. The only basis suggested for such distinction is that the "net loss" deductions pertain to prior years whereas the deductions under Section 234 (a) are "current." The Court below attempted to state the basis of this discrimination thus:

> "We think the assumption of appellant and its argument in support of it overlooks the point that taxes go by years, and that though in the taxable year in question the individual corporations are still taxpayers, the business is really regarded for the purpose of taxation, as a unit, and as such subject to tax on the business of that year. Because the income on which the tax shall be paid in the taxable year, though

made up of the results of the business of each affiliate, is not the income of each individual taxpayer, but the income of the unit for that year, the Commissioner was right in allowing against the aggregate gross income of the business for that year the *aggregate deductions applicable to that year.*" (Italics ours.) (R. 22.) 53 F. (2d) at 824.

But the Circuit Court of Appeals has not shown that the "net loss" deductions available to Piedmont Savings Company by reason of the "net losses" incurred in 1925 and 1926 are not *applicable* to 1927. *Under the express terms of Section* 206 (b) *these net loss deductions are made "applicable to that year."* It matters not that the circumstances and events which gave rise to the deductions occurred in prior years, perhaps prior to affiliation. Under the Statute the benefit of the deductions was to be reaped in 1927. The mere fact that the principal circumstances or events which gave rise to the deduction occurred prior to affiliation does not afford a basis of discrimination by excluding such deduction in the computation of consolidated net income for the year in which the statute makes that deduction applicable.

Suppose that the excess of Piedmont Savings Company's deductions under Section 234 (a) over its gross income for 1927, namely the sum of $453.80 (R. 3), was due entirely to a loss on the sale of properties which Piedmont Savings Company had acquired years before, and prior to affiliation. The deduction for such a loss is made applicable to the year 1927, under the terms of the statute, even though the depreciation in values occurred long before then. Would the Circuit Court of Appeals hold

that this is a loss purely personal to the corporation sustaining it, having no reasonable connection with the current business of the affiliated group for 1927? Would the Circuit Court of Appeals exclude such a deduction from the consolidated returns for 1927, on the theory that a "ruling which permits a corporation having a consistent record of gains, to affiliate with one having a large accumulation of" depreciated investments which could be sold at tremendous losses, "with the result of using these losses in the year of affiliation as deductions from its income in that year, appears generally inappropriate to the Federal scheme of income taxation"?[7]

No one has ever suggested that an affiliated group may not deduct the full amount of losses which a member corporation has thus suffered from the sale of investments which had depreciated prior to affiliation, even where such losses exceed the gross income of the member suffering them.

Other examples besides those given under this and the preceding headings may be thought of which will illustrate the point which we are urging: namely, that it is utterly unreasonable to hold that the Commissioner is given power in any case arbitrarily to determine, upon the basis of his understanding of the Congressional intent and appropriateness to the general scheme of Federal taxation, whether a particular deduction is to be allowed in the computation of consolidated net income. Results under the consoli-

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[7]Cf. the language quoted from the opinion of the Circuit Court of Appeals, pp. 29, 30, supra.

dated returns section and the Regulations thereunder, as under other provisions of the Revenue Acts, are to be determined by language of the statute and Regulations and not by considerations of "equity."

6. Affiliation or Non-affiliation at Time "Net Loss" Was Incurred Is Immaterial.

There is absolutely nothing in the language of the statute which would warrant or even suggest a distinction in the present case if Piedmont Savings Company and Petitioner had been affiliated in 1925 and 1926 when the net losses in question occurred. The contentions of the Government, as set forth under Heading 2 above, if held to prevent the deduction sought in the present case, would apply equally though the Piedmont Savings Company and Petitioner had been affiliated throughout the years 1925, 1926 and 1927. It is impossible to distinguish the two cases on the language of any of the provisions in the statute or regulations relating to consolidated returns or to "net losses."

Counsel for Respondent at the argument before the Circuit Court of Appeals admitted frankly that affiliation or non-affiliation at the time the net loss occurred was immaterial so far as any argument of the Government was concerned. It is presumed that the Solicitor General will make the same admission before this Court. In any event, the Bureau of Internal Revenue has taken the position that the same rules are applicable to both cases. G. C. M. 8132, IX—1 C. B. 287.

The Circuit Court of Appeals, however, in its opinion in the present case seized upon the so-called

"equities" of the situation and laid great stress upon the fact that Piedmont Savings Company and Petitioner were not affiliated when the "net losses" occurred. This consideration had also largely influenced the District Court in reaching a conclusion adverse to Petitioner. A few days after the decision in the present case the Circuit Court of Appeals for the Fifth Circuit was presented with a situation where the "equities" were exactly the same as though legal affiliation had existed throughout the entire period. See *Planters Cotton Oil Co. v. Hopkins*, 53 F. (2d) 825. The Court then ignored the "equities" and held still that the "net loss" could not be deducted to an extent greater than the income of the corporation which sustained it and said that this result was required by the language of the statute. In that case the Court seemed to rely principally upon the argument that the "net loss" deduction is a deduction personal to the "taxpayer" which sustained it; ignoring entirely the fact that Sections 206 (b) and 234 (a), when read out of connection with the consolidated returns provisions, are applicable only to the single taxpayer which sustained the deductions provided.

7. Petitioner Does not Contend that a "Net Loss" can be Deducted in Computing a "Net Loss."

A patently fallacious argument has been urged by the Government in several of its briefs on this subject and misled the District Court in this case and the Circuit Court of Appeals in the case of *Commissioner v. Ben Ginsburg Co.*, 54 F. (2d) 238 (C. C. A. 2nd, 1931). This is the argument to the effect that the treatment of "net loss" for which Petitioner here contends would result in allowing a "net loss" for one year to be taken into consideration in computing a

"net loss" for the succeeding year. Of course a "net loss" from one year cannot be used in determining a "net loss" in a succeeding year. "Net loss" even more clearly, if possible, than "net income" is a creature of statute. Not all net losses commonly so called are "net losses" under the statute.[8] Section 206 provides just what deductions are to be taken in computing a "net loss." A "net loss" from a preceding year is not among the deductions provided in this section. So, of course, it cannot be deducted. But this has no bearing upon the question as to whether it can be deducted in computing "net income" so as to give a minus figure to go into consolidated "net income." "Net income," when a minus quantity, is not in any sense under the statute synonymous with "net loss." Dividends received from another corporation cannot be deducted in computing a "net loss" to be carried forward [Section 206 (a) (4)], but no one would have the temerity to suggest that they may not be deducted in the computation of corporate "net income," even though the result may be to create a minus quantity to be carried into a consolidated return.

Of course if the proper method of computing "consolidated net income" is to take the aggregate of the gross income minus the aggregate of the deductions, a "net loss" is not used to produce a minus quantity for any purpose, and therefore no one would even sug-

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[8]Reg. 69, Art. 1621 . . . In order to be entitled to claim an allowance for a 'net loss' the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowed may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the statute . . ."

gest that a "net loss" is being used in the computation of a "net loss."

8. State of the Authorities.

The question involved in this case has been before three Circuit Courts of Appeals in four cases.[9] The Third Circuit has decided in favor of the taxpayer. The Second and Fifth Circuits have decided against the taxpayer. Two District Courts have considered the question and they have decided against the taxpayer.[10]

The Board of Tax Appeals at first sustained the Government's position.[11] However, when the matter was more fully presented to the Board of Tax Appeals, it overruled its earlier decision and held in a long line of cases in favor of Petitioner's position.[12]

However, after the decision in the present case and the decision in the Circuit Court of Appeals for the

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[9]National Slag Co. v. Commissioner, 47 F. (2d) 846, (C. C. A. 3rd, March 3, 1931); Commissioner v. Ben Ginsburg Co., 54 F. (2d) 238 (C. C. A. 2nd, Nov. 2, 1931); Woolford Realty Co. v. Rose, 53 F. (2d) 821 (C. C. A. 5th, Nov. 13, 1931); Planters Cotton Oil Co., Inc. v. Hopkins, 53 F. (2d) 825 (C. C. A. 5th, Nov. 20, 1931). The cases in this footnote and the footnote following are sufficiently discussed in the body of the brief.

[10]Woolford Realty Co. v. Rose, 44 F. (2d) 856 (N. D. Ga., Nov. 14, 1930); Planters Cotton Oil Co., Inc. v. Hopkins, 47 F. (2d) 659 (N. D. Tex., Mar. 2, 1931).

[11]Alabama By-Products Corp., 16 B. T. A. 1073; National Slag Company, 16 B. T. A. 1310.

[12]Alabama By-Products Corp., 18 B. T. A. 919; Ginsburg Co., 19 B. T. A. 81; Buckie Printers' Ink Co., 19 B. T. A. 943; Pittsburgh Gasoline Co., 21 B. T. A. 297; General Box Corporation, 22 B. T. A. 725; Arrow Coal & Ice Company, 22 B. T. A. 1341; Tolerton & Warfield Company, 23 B. T. A. 892; Hawley Investment Company, 23 B. T. A. 953; Milgrim & Bros., Inc., 24 B. T. A. 853; Smalls, Inc., 24 B. T. A. 686; Summerfield Co., 24 B. T. A. 829.

Second Circuit in the *Ginsburg* case (note 9 *supra*), the same question again came before the Board in a case which was appealable to the Circuit Court of Appeals for the Second Circuit, and the Board of Tax Appeals reversed its previous position and held in favor of the Commissioner.[13]

Great reliance was placed below upon the case of *Swift & Company v. United States*, 38 F. (2d) 365 (Ct. Cls. 1930) and on the case of *Sweets Co. v. Commissioner*, 40 F. (2d) 436 (C. C. A. 2nd 1930). Both of these cases are authority for the proposition that a corporation in an affiliated group remains the taxpayer, and that the group is not a taxpayer. We have no quarrel with this proposition and have assumed its soundness throughout our brief. Beyond this proposition the *Sweets Company* case has no bearing whatever upon the present question.

In the *Swift & Company* case one of the questions involved was the right to use in the consolidated returns of an affiliated group for 1918 the full amount of a net loss suffered by one of the members of the group in 1919. The case turned upon a proper construction of Section 204 (b) of the Revenue Act of 1918 which provided that where "a taxpayer has sustained a net loss" for a year prior to January 1, 1920, "the amount of such net loss shall . . . be *deducted from the net income* of the taxpayer for the preceding taxable year." The Court of Claims held that under this statutory provision the amount of the "net loss" incurred by one member of the group in 1919 could be used in the consolidated returns for 1918 only to the extent of wiping out the net income, for 1918, of the particular corporation sustaining the

[13]Bowman Hotel Corp., 24 B. T. A. 1193.

"net loss." It will be noticed that the pertinent language of Section 204 (b) of the Revenue Act of 1918 which was the subject of construction in the *Swift* case is substantially different from the language of Section 206 (b) of the Revenue Act of 1926 which is involved in the case at bar.

In the present case, instead of providing that the "net loss" shall "be *deducted from the net income of the taxpayer*," the statute here involved provides that the amount of the "net loss" "shall be allowed as a deduction *in computing the net income of the taxpayer*." This difference in the wording of these two statutory provisions has been held to afford a substantial legal distinction. Cf. *Warren-Nash Motor Company*, 21 B. T. A. 897 with *Alabama By-Products Company*, 18 B. T. A. 919. And see the well written opinion of Judge Coleman in the case of *Burnet v. Moore Cotton Mills*, 49 F. (2d) 59 (C. C. A. 4th, 1931). The approach to a question of statutory construction of the Circuit Court of Appeals for the Fourth Circuit in the case last cited is in striking contrast with the approach of the Circuit Court of Appeals for the Fifth Circuit in this case, and in the case of *Planters Cotton Oil Company v. Hopkins*.

None of the other authorities cited by the Courts below or by the Government in its briefs have any bearing upon the question here involved and for that reason it is not felt necessary to discuss them.

Conclusion

Under Headings 1 and 2 above we believe we have shown beyond the possibility of doubt that the language of the statute and regulations requires the

result for which we contend. The Petitioner rests its case squarely upon the plain and unambiguous language of the Revenue Act of 1926 and the Regulations thereunder, which clearly require a decision in Petitioner's favor.

If it should be conceded that the slightest ambiguity exists, it would not be necessary to call the Court's attention to the rule requiring all provisions of Revenue Acts—including those relating to *deductions* and even provisions thereof constituting statutes of limitations against the Government—to be construed most strictly in favor of the taxpayer.[14]

We have gone into the so-called "equities" of the situation not because we feel that they should have any bearing upon the situation in view of the clear and unambiguous language of the statute and regulations, but only because the Government and the Court below have been so impressed by supposed "equities" and imaginary "evils."

Respectfully submitted,

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April, 1932.

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[14]Bowers v. New York & Albany Lighterage Company, 273 U. S. 346, 350 (1927); United States v. Updike, 281 U. S. 489, 496 (1930); Crooks v. Harrelson, 282 U. S. 55, 61 (1930); Burnet v. Niagara Falls Brewing Co., 282 U. S. 648.

APPENDIX

Statutes and Regulations Involved

Revenue Act of 1926, Section 232:

In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, . . .

Revenue Act of 1918 (c. 18, 40 Stat. 1057), Section 232:

That in the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by section 234 . . .

Revenue Act of 1926, Section 234(a):

In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

[There are then listed, under sub-paragraphs (1) to (11), all deductions permitted in determining net income, except "net losses" brought forward from preceding years, which is covered by Section 206. The deductions listed under Section 234(a) include ordinary and necessary expenses, interest and taxes paid, losses sustained, bad debts, dividends from domestic corporations, depreciation, obsolescence and depletion.]

Revenue Act of 1926, Section 206(a) and (b):

(a). As used in this section the term "net

loss" means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to paragraph (2) of subdivision (c) of section 204;

(4) The deduction provided for in paragraph (6) of subdivision (a) of section 234 of amounts received as dividends shall not be allowed;

(5) There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234.

(b). If, for any taxable year, it appears upon the production of evidence satisfactory to the

Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1061), Section 204(b):

(b). If for any taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be *deducted from the net income of the taxpayer for the preceding taxable year;* and the taxes imposed by this title and by Title III for such preceding taxable year shall be redetermined accordingly. Any amount found to be due to the taxpayer upon the basis of such redetermination shall be credited or refunded to the taxpayer in accordance with the provisions of Section 252. If such net loss is in excess of the net income for such preceding taxable year, *the amount of such excess shall* under

regulations prescribed by the Commissioner with the approval of the Secretary *be allowed as a deduction in computing the net income for the succeeding taxable year.* (Italics ours.)

Revenue Act of 1926, Section 240(a) and (b):

(a). Corporations which are affiliated within the meaning of this section may, for any taxable year make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b). In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236.

Regulations 69, Article 635:

Consolidated net income of affiliated corporations.—Subject to the provisions covering the determination of taxable net income of separate

corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several corporations consolidated. Only one specific credit of $2,000, as provided in section 236 (b) and article 591, shall be allowed the consolidated group; and this only in case the net income of the group does not exceed $25,000; but if such net income is more than $25,000, the tax imposed by section 230 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000. In respect of the statement of gross income and deductions and the several schedules required under Form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

Revenue Act of 1928, Section 117(a) and (b):

[Section 117 (a) of the Revenue Act of 1928 *defines* "net loss" under the 1928 Act and does not differ in any way here material from Section 206 (a) of the Revenue Act of 1926, page 41, supra. Section 117 (b) with reference to the *deduction* of "net losses" is *identical* with Section 206 (b) of the Revenue Act of 1926, page 42, supra.]

Revenue Act of 1928, Section 141(a), (b) and (c):

(a) *Privilege to file consolidated returns.*—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) *Regulations.*—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(c) *Computation and payment of tax.*—In any case in which a consolidated return is made the tax shall be determined, computed, assessed,

collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the date on which such return is made. Only one specific credit computed as provided in section 26 (b), shall be allowed in computing the tax.

Regulations 75, Article 31(a) (Under Revenue Act of 1928):

Definition.—Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as "intercompany transactions").

Regulations 75, Article 41(c) (Under Revenue Act of 1928):

Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.—A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corpora-

tion; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.